No. 12305

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDWARD M. MILLS, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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OPINION BELOW

The only previous opinion is that of the Tax Court promulgated March 28, 1949 (R. 61-73), which is reported in 12 T. C. 468.

JURISDICTION

The petition for review (R. 75-77) involves deficiencies in federal gift taxes determined by the Commissioner of Internal Revenue against the taxpayer, Edward M. Mills, for the gift tax year 1943 in the amount of $5,032.45, for the gift tax year 1944 in the amount of $3,157.46, and for the gift tax year 1945 in the amount of $2,807.77. On August 9, 1946, the Commissioner mailed the taxpayer a notice of deficiency in gift taxes for the gift tax years 1943 and 1944 in the aggregate amount of $8,189.91. (R. 9-13.) Within 90 days thereafter, and on October 16, 1946, the taxpayer filed a petition with the Tax Court of the

United States for a redetermination of such deficiency under the provisions of Section 1012(a)(1) of the Internal Revenue Code. (R. 5-13.) On November 20, 1946, the Commissioner mailed to the taxpayer, a notice of deficiency in gift tax for the gift tax year 1945 in the amount of $2,807.77. (R. 18-20.) Within 90 days thereafter, and on February 11, 1947, the taxpayer filed a petition with the Tax Court of the United States for a redetermination of such deficiency, also under the provisions of Sections 1012(a)(1) of the Code. (R. 15-20.) The two proceedings were consolidated for hearing before the Tax Court. (R. 22-20.) The decision of the Tax Court that there are no deficiencies in gift tax for the years 1943 and 1944 was entered March 28, 1949 (R. 73), and its decision that there is no deficiency in gift tax for the year 1945 was entered on March 28, 1949 (R. 74). The proceeding is brought to this Court by a petition for review filed June 21, 1949 (R. 75-76), under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether an agreement entered into between the taxpayer and his wife on January 1, 1939, in so far as it contemplated a division of the taxpayer's future earnings between him and his wife into the separate property of each, precluded the imposition of the federal gift tax upon the taxpayer in each of the gift tax years 1943, 1944 and 1945 in respect of the moiety of such earnings which she physically received as her separate property in each of those years upon the actual division thereof.

2. If not, then whether the actual division of such earnings in each of those years between the taxpayer and his wife into the separate property of each constitutes a gift by him to her of a moiety thereof in each

of those years within the meaning of Sections 1000(a) and (d) and 1002 of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The statute and Regulations involved are set out in the Appendix, *infra.*

STATEMENT

The Tax Court adopted the stipulation of the parties from which, together with oral testimony and exhibits introduced at the hearing, it found the facts as follows:

The taxpayer is an individual residing in San Francisco, California, and seasonably filed his gift tax returns for the years 1943, 1944 and 1945 with the Collector of Internal Revenue for the First District of California. (R. 62.)

The taxpayer is married and he and his wife, Edna Mills, are now, and have at all times since July 29, 1927, been husband and wife and residents of California. (R. 62.)

On or about January 1, 1939, taxpayer and his wife entered into an oral agreement by which they divided equally between them all community property owned by them on December 31, 1938, with the understanding and agreement that thereafter each of them would own and hold the one-half of the community property so allotted and delivered to each as his or her separate property. (R. 62.)

The agreement did not include or relate to the future salary and earnings of the taxpayer. The taxpayer for many years prior thereto had each month voluntarily and without any obligation so to do paid to his wife one-half of his salary, and it was understood that he would continue so to do, but there was no agreement or binding obligation that he would do so, and the payments of salary as received by him from his employer continued to be the community property of himself and his wife. (R. 62.)

Their community property on December 31, 1938, consisted of various stocks and bonds in the names of the taxpayer or the taxpayer and Edna Mills, jointly, and pursuant to the agreement these were equally divided, one-half of them being transferred to Edna Mills and thereafter held in her name and one-half in the name of the taxpayer. Separate books of account were then set up and thereafter kept for the taxpayer and his wife. In his appears this entry, dated January 1, 1939:

> To transfer to Edna Mills her one-half interest in the community property at December 31, 1938,

followed by a list of the securities so transferred to Edna Mills, which were carried on the taxpayer's books of account at the amount of $270,973.13. At all times thereafter separate bank accounts were kept for the taxpayer and his wife and the separate income of each was deposited to the credit of each in their respective bank accounts. (R. 62-63.)

Continuously since January 1, 1939, and prior thereto one-half of the taxpayer's salary as received by him has been delivered by him to his wife. During that time the taxpayer has been an officer and director in one corporation and a director in another. His salary as such officer was payable in equal semi-monthly installments after deductions were made therefrom for federal old age benefit tax imposed on employees, the State of California unemployment insurance tax, the federal withholding tax on wages, group insurance premiums, and for the purchase of U. S. Savings Bonds, Series E. Continuously since January 1, 1939, checks covering these semi-monthly payments of salary, after these deductions, were delivered and made payable to the taxpayer. One of the checks for each month was deposited by the taxpayer's secretary in his separate bank account and the other was indorsed by the taxpayer's secretary on his behalf to the order of his wife and deposited by his secretary in his wife's separate bank account. (R. 63-64.)

During 1943, 1944 and 1945, the deduction from salary payments to the taxpayer with which to purchase U. S. Savings Bonds totaled $4,800 in each year, of which $2,400 was expended to purchase such bonds in the taxpayer's name and $2,400 to purchase such bonds in his wife's name. Checks for director's fees were deposited in the taxpayer's separate bank account and at the end of each year adjustment was made so that one-half thereof was credited to his wife. The federal old age benefit tax was treated as chargeable solely to the taxpayer, and his wife was given credit for such deductions. (R. 64.)

The total compensation received for personal services rendered by the taxpayer for the years 1943 to 1945, inclusive, was as follows (R. 64):

Salary, Rayonier, Incorporated, 1943, $50,623.92; 1944, $33,957.32; 1945, $30,738.

Director's fees, 1943, $240; 1944, $240; 1945, $220.

Total, 1943, $50,863.92; 1944, $34,197.32; 1945, $30,-958.00.

In arriving at the deficiencies involved in these proceedings, the Commissioner determined that the taxpayer made taxable gifts to Edna Mills in the amounts of one-half of the total compensation received for personal services rendered by the taxpayer for each of the years. The Commissioner admits that he erroneously determined that one-half of the total compensation for the years 1943 and 1944 were the amounts of $25,366.44 and $17,033.14, respectively, instead of the amounts of $25,431.96 for 1943 and $17,098.66 for 1944. (R. 64-65.)

The taxpayer and Edna Mills filed separate federal income tax returns for each of the calendar years 1939 to 1945, inclusive. The taxpayer included in his separate income tax returns one-half of the salary and other compensation for personal services rendered by him, and Edna Mills included in her separate income tax returns one-half of the salary and other compensation. (R. 65.)

For the years 1943 the total amount of the taxpayer's net gifts for preceding taxable years was $142,407.11; for 1944 and 1945 the same amount, plus the amount of any taxable gifts that may be determined herein. (R. 65.)

In arriving at the taxpayer's net gifts for preceding taxable years, the Commissioner did not treat the receipt by Edna Mills (taxpayer's wife) of any of the compensation for personal services of the taxpayer during the years 1939 to 1942, inclusive, as taxable gifts by taxpayer, although taxpayer in each of those years did deliver to his wife one-half of his salary and all compensation received by him. Neither did the Commissioner contend that the compensation payments made by taxpayer to his wife from 1939 to 1942, inclusive, constituted taxable gifts, and taxpayer filed no gift tax returns therefor. (R. 65.)

To prevent imposition of penalty, taxpayer filed gift tax returns for each of the years 1943, 1944 and 1945, setting out the facts and the amounts contributed to his wife, but claiming therein that there was no gift tax due. (R. 66.)

The Commissioner's notice of deficiency to taxpayer for the calendar year 1943 contained this statement (R. 66.):

> (a) It has been determined that one-half of your salary, or $25,366.44 (½ of $50,732.88) which was converted to separate property of your wife during

> the calendar year 1943, constitutes a taxable gift within the meaning of Article 86.2(c) of Regulations 108.

The Commissioner's defincieney notices to the taxpayer for 1944 and 1945 each contained a statement identical with the above, except in the one for 1944 one-half of the taxpayer's salary was alleged to be $17,-033.14, and in the one for 1945 one-half of the taxpayer's salary was given as $15,479. (R. 66.)

The Tax Court held that, though the taxpayer's earnings constituted community property in each of the gift tax years in which they were received, their division in each of such years between the taxpayer and his wife did not constitute gifts of a moiety thereof from the taxpayer to his wife. (R. 66-72.) Accordingly, the Tax Court reversed the Commissioner's imposition of the gift tax thereon.

STATEMENT OF POINTS TO BE URGED

1. The Tax Court erred in holding that Congress did not intend to include in Section 1000(d) of the Internal Revenue Code a division of community property between the spouses into the separate property of each, and in striking down Section 86.2(c) of Treasury Regulations 108 to that effect.

2. The Tax Court erred in refusing to sustain the Commissioner's deficiency determinations in taxpayer's gift taxes for the gift tax years 1943, 1944 and 1945 and in entering its decisions to the effect that there were no deficiencies in such taxes in those years.

SUMMARY OF ARGUMENT

I

The January 1, 1939, agreement between the taxpayer and his wife did not preclude the imposition of the gift tax upon the taxpayer under Sections 1000(a) and (d) and 1002 of the Internal Revenue Code.

A. The Tax Court found that despite the January 1, 1939, agreement the taxpayer's earnings continued to be the community property of himself and his wife in the gift tax years here in question, in which they were received. Such finding is supported by the evidence and should be sustained.

B. Even assuming that the January 1, 1939, agreement was effective to convert such earnings into the separate property of the spouses, it was nevertheless ineffective to prevent the application of Section 1000(d). Such an agreement is to be regarded as being merely an anticipatory arrangement which could not prevent the imposition of the tax in respect of a division which actually occurred only in the taxable years. The reason is that, for purposes of the gift tax, Congress attributed the ownership of the income to the spouse who earned it. There is nothing in the cases decided by this Court or in those decided by the appellate courts of California, which prevents the application of this principle here.

II

The division of the taxpayer's earnings between himself and his wife in the taxable years in question into the separate property of each constitutes a gift by him to her of a moiety thereof in each of those years, within the meaning of Section 1000(d) of the Code.

A. Section 86.2(c) of Treasury Regulations 108 provides that Section 1000(d) applies to divisions of community property into the separate property of the spouses. In determining whether these Regulations correctly interprets Section 1000(d), the decision of this Court in the *Rickenberg* case should be put aside. In the 1948 Act, Congress has adopted the construction of

Section 1000(d) placed thereon by the Regulations. Thus, by Section 812(e)(2)(C)(i) and 1004(a)(3)(F)(iii), which were added to the Code by the 1948 Act, Congress included in the estate and gift tax bases, for marital deduction purposes, divisions of community property made during the period in which the 1942 estate and gift tax amendments to the Code were effective. The obvious reason is that, during that period, the gift tax was payable in respect of such divisions under Section 1000(d) and the Regulations. The language of Section 1000(d) clearly covers a transfer by division of the community property between the spouses. The basic premise of Section 811(d)(5) relating to the estate tax and of Section 1000(d) relating to the gift tax is that Congress attributed the ownership of the community property to the spouse to whom it was economically attributable, in disregard of state law which attributes the ownership of one-half thereof to each spouse. It was within the power of Congress to do so. The statute does not prohibit the result achieved by the Regulations, and there is no possible reason for assuming that Congress did not intend to achieve such a result. To the contrary, the section would fail of its purpose to equalize the tax between common law and community property states, unless Section 1000(d) encompassed interspousal transfers of community property. The question is not whether the Regulations are free from all doubt, but whether they are reasonable; and, before they may be stricken down, it must appear that they are plainly inconsistent with the statute. That is not the situation here; for, as stated, the Regulations are in harmony with the statute and obviously implement the purpose of Congress to equalize the tax burden throughout the United States; and, to that end, they disregard the differences in the local laws of property. In this connection, the term "gifts," used in the statute, has no common law connotation, and a donative intent is not required. It, moreover, includes the abandonment or relinquishment of rights in property; and the shifting of the husband's rights in the wife's half of the property is an adequate basis for the tax here.

B. There was no adequate and full consideration in money or money's worth for the transfer, within the meaning of Section 1002. No common law consideration is necessary. Mutual promises are insufficient to satisfy the statutory requirements. The consideration must benefit the donor in money or money's worth, and must do so adequately and fully. Neither benefit nor detriment to the donee is consideration. The purpose of Congress is enacting Section 1000(d) was to reach those gifts which are thereby withdrawn from the donor's estate. Moreover, ordinarily interspousal transactions are not business transactions, and, unless they are, they do not fall within the ambit of Section 1002. In any case, Congress would have done a futile act in imposing the gift tax upon divisions of community property, in order to equalize the tax, if it were to be defeated by the fact that, as a result, each spouse received a moiety of the property of equal value, which, indeed, each already "owned."

ARGUMENT

Preliminary

The Tax Court rejected the taxpayer's contention that, in virtue of the agreement entered into between him and his wife on January 1, 1939, the taxpayer's earnings in each of the gift tax years 1943, 1944 and 1945 did not constitute community property. On the other hand, the Tax Court rejected the Commissioner's contention that the division of such earnings in each of such years resulted in a gift in each year by the taxpayer to his wife of a moiety of such earnings under

Sections 1000(a) and (d) and 1002 of the Internal Revenue Code (Appendix, *infra*). Accordingly, the Tax Court expunged the deficiencies in gift taxes determined by the Commissioner against the taxpayer in each of such years.

Since the taxpayer has already indicated that he intends here to renew his contention that his 1943, 1944 and 1945 earnings did not constitute community property in each of those years, but constituted the separate property of himself and his wife in virtue of the 1939 agreement, we shall anticipate such contention and address our first point thereto. In this connection, we shall, however, further point out that, even assuming the agreement to have been effective to convert the taxpayer's earnings from community into the separate property of the spouses, still, under familiar principles, the taxpayer cannot by virtue of the agreement escape the impact of Section 1000(d) upon the division of such earnings in the year in which he earned them and in which they were received by him, if such division would, except for the agreement, attract the tax. And this leaves for discussion under our second point what we regard as the error of the Tax Court in holding that the division of such earnings in each of those years between the taxpayer and his wife did not constitute taxable gifts by him to her of a moiety thereof, under the above-mentioned sections.[1]

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[1] Since we cannot, of course, anticipate the full course of the taxpayer's contention with regard to the character of the agreement, we must necessarily reserve our right to answer such argument in a reply brief.

I

The January 1, 1939, Agreement Between the Taxpayer and His Wife Did Not Preclude the Imposition of the Gift Tax Upon the Taxpayer under Sections 1000(a) and (d) and 1002 of the Code in Respect of the Division of Community Property Between Him and His Wife

The Tax Court found that, despite the January 1, 1939, agreement between the taxpayer and his wife, the salaries and other compensation which the taxpayer received from his employers continued to be the community property of himself and his wife. We think the evidence amply supports that finding. However, the taxpayer cannot prevail here, even if his present interpretation of the agreement is accepted, for under well-recognized principles of law such an anticipatory arrangement cannot serve to defeat the tax. We shall present these points separately. Thus, under our subpoint A, we shall undertake to show that evidence sustains the Tax Court's finding, and under subpoint B that, in any event, the agreement cannot prevent the division of the actual community property in the gift tax years here in question from attracting the tax.

A. *The taxpayer's 1943, 1944 and 1945 earnings constituted community property in each of those years*

For a number of years prior to 1939 the taxpayer and his wife had regularly divided his earnings between them as and when he received them. On January 1, 1939, they entered into an oral agreement to divide their community property into separate property. The agreement was, however, indefinite both as to its character and as to its effectiveness in point of time.

The only witness called to testify with regard thereto was the taxpayer himself. He stated that there was an agreement on January 1, 1939, between himself and his wife with respect to salary or compensation for services to be rendered by him in the future; that he and his wife had always divided his salary and that such division was continued under the agreement and took place month by month; also, that under the agreement the community property owned by him and his wife at the time it was entered into was then divided physically between them, she receiving certain securities and he keeping certain others. (R. 33.) Further, with regard to the division of his salary or compensation, he said that, under the agreement, one-half thereof was to be his wife's. (R. 34.) By this he referred to the "salaries and directors' fees," which he expected to earn in the future (R. 37), for that was "the only Kno means of compensation outside of dividends and interest" (R. 38). It appeared in the course of his testimony that in an affidavit attached to his gift tax return for 1943 he had stated he and his wife had "agreed that all income to be received thereafter from salary or other compensation for personal services which would otherwise have been received as ~~the~~ any community income should be received by each as his or her separate income or property." (R. 38.) He explained, however, the language used by him in this affidavit did not purport to be his actual language but merely his recollection of the circumstances. (R. 39.) He stated the occasion for making the agreement was that he had been apprised of a change in the income tax act, and that the division of the salaries he had been making was more or less questioned by the Bureau of Internal Revenue. (R. 39.) And, in answer to a question propounded by the Tax Court as to whether or not the agreement was entered into on the advice of counsel, he said he thought so. (R. 41.)

But, after repeating his statement that the agreement had been entered into because of questions raised by the Bureau and in order to eliminate controversy with respect of the community property, he again said that under the agreement one-half of his salary and personal earnings was to be his wife's property; that she had no earnings since she had never been employed. (R. 42.)

As to the term of the agreement the taxpayer said that, as far as he knew, it was to continue for the rest of their lives (R. 34), and that he did not understand he could terminate it without his wife's consent (R. 42).

The taxpayer argued below that the agreement was effective not only to divide their existing community property between himself and his wife into the separate property of each, but his future earnings as well. The Tax Court's holding, however, is to the effect that such was not the effect of the agreement in so far as it concerned the taxpayer's future earnings and we agree with that conclusion. As stated, the agreement was not only oral and indefinite, but was made solely because of a controversy which had arisen between the taxpayer and the Bureau of Internal Revenue as to the character of some of his property, that is, whether it was his separate property or community property. The exact nature of the controversy is not disclosed, but it is apparent that the agreement was entered into on the advice of counsel and for the sole purpose of affecting tax consequences. (R. 39, 41, 42.)

This Court has held, speaking through Judge Dietrich, that in interpreting an equivocal transaction, such as we obviously have here, its motives may be considered as bearing upon its real nature. *Brunton* v. *Commissioner,* 42 F. 2d 81, 82. Similarly, in *Texas & N. O. R. Co.* v. *Ry. Clerks,* 281 U. S. 548, cited by Judge Dietrich in the *Brunton* case, Mr. Chief Justice Hughes, speaking for a unanimous Court said (pp. 559-560):

> Motive is a persuasive interpreter of equivocal conduct, and the petitioners are not entitled to

> complain because their activities were viewed in the light of manifest interest and purpose. The most that can be said in favor of the petitioners on the questions of fact is that the evidence permits conflicting inferences, and this is not enough.

Moreover, as the Fourth Circuit said in *Tazewell Electric Light & Power Co.* v. *Strother,* 84 F. 2d 327, in such circumstances, the transaction is to be construed jealously against the taxpayer.

It is, of course, well settled that the trier of the fact is not bound by the declaration of a purpose made by an interested party, but is free to find from all the facts what the real situation was. See *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 295; *Helvering* v. *Stock Yards Co.,* 318 U. S. 693, 701; *Rand* v. *Helvering,* 77 F. 2d 450 (C.A. 8th); *United States* v. *Washington Dehydrated Food Co.,* 89 F. 2d 606, 609 (C.A. 8th). The Tax Court is well aware of this principle and has again and again been guided by it, often with the approval of the appellate courts. See, e.g., *William C. De Mille Productions, Inc.,* v. *Commissioner,* 30 B.T.A. 826, 829; *Reynard Corp.* v. *Commissioner,* 37 B.T.A. 552, 563; *R. L. Blaffer & Co.* v. *Commissioner,* 37 B.T.A. 851, 856, affirmed 103 F. 2d 487 (C.A. 5th), certiorari denied 308 U. S. 576, rehearing denied, 308 U. S. 635; *W. S. Farish & Co.* v. *Commissioner,* 38 B.T.A. 150, 158, affirmed 104 F. 2d 833 C.A. 5th); *Schoenberg* v. *Commissioner,* 30 B.T.A. 659, 661, affirmed 77 F. 2d 446 (C.A. 8th), certiorari denied 296 U. S. 586; *Seymour* v. *Commissioner,* 27 B.T.A. 403, 405; *Powell* v. *Commissioner,* 34 B.T.A. 655, 659. It is, moreover, wholly immaterial that the Tax Court did not say in so many words that it did not believe the taxpayer's declaration of purpose in making the agreement, if by his testimony he intended to be understood as implying that by the agreement he and his wife intended to convert his future earnings into separate property. It is unnecessary for the Tax Court to state that it did not believe the taxpayer in his declarations of purpose if such was their purport. Simply, to say as the Tax Court did, that the agreement did not include or relate to the taxpayer's future salary and earnings and that there was no binding agreement or obligation that he would divide his earnings with his wife in the future, and that, therefore, the payments of salary as received by him from his employer continued to be community property of himself and his wife, is more polite and less offensive, and at the same time equally sufficient. *Stone* v. *United States,* 164 U. S. 380, 382. We submit that in the circumstances it is inappropriate to force a contrary conclusion upon the Tax Court.

Taking, then, the indefiniteness of the agreement, as well as its purpose to affect undisclosed tax consequences, into consideration, it is obvious we think that the Tax Court did not err in reaching the conclusion that the agreement was not intended to and did not in point of fact serve to impress the future earnings of the taxpayer with the character of separate property. Thus, assuming that an agreement could have been framed so as effectively to convert future earnings into separate property, as this Court held it could be in *Earl* v. *Commissioner,* 30 F. 2d 898, reversed on other grounds, in *Lucas* v. *Earl,* 281 U. S. 111, 115, the finding here is that such was not the agreement, and, as we have said, that finding should not be disturbed.

In this connection, it is to be noted that, in *Earl* v. *Commissioner, supra,* this Court distinguished its prior decision in *Blair* v. *Roth,* 22 F. 2d 932, 934, on the sole ground that the agreements in the two cases were different. Thus, in the *Roth* case, it regarded an agreement similar to that here as being one merely for the future assignment by each of the parties of one-half of his or her earnings to the other. After stating that the Commissioner did not question that, under the California statute and decisions, referring to Section 159 and Section 160 of the Civil Code and *Wren* v. *Wren,* 100 Cal. 276; *Kaltschmidt* v. *Weber,* 145 Cal. 596; *Smith* v. *Smith,* 47 Cal. App. 650, and *Perkins* v. *Sunset T. & T. Co.,* 155 Cal. 712, a husband and wife domiciled in that state may make valid agreements relating to either their separate or their community property or that it would be competent by appropriate agreement between them to constitute the earnings of the wife her separate property, the Court, also speaking through Judge Dietrich, said (p. 934):

> In essence his [the Commissioner's] contention is that, at most, the agreement here was for an assignment by each of the parties of one-half of his or her earnings to the other; that, at the instant they were received, the salaries were, by the law, impressed with the status of community property, and were taxable with reference to that status; and that the obligation to pay the tax so computed could not be escaped by contributing such incomes to the so-called partnership between the two members of the community, any more effectually than by contributing it to a like enterprise as between one member of the community and a third person. In this view we concur.

It is further to be noted that in the case of *Belcher* v. *Lucas,* 39 F. 2d 74, which was decided by this Court after the *Earl* case had been reversed by the Supreme Court, it in turn distinguished its decision in that case. Here again the distinction was based upon the difference in the nature of the agreements in the two cases. Thus, speaking of the agreement in the *Belcher* case, this Court in its opinion in that case said (p. 75):

> Reliance is had upon an oral agreement made prior to the marriage of petitioner and his wife,

which occurred on December 5, 1903, at Los Angeles, Cal., under which, to use the language of his brief, "it was understood that both would continue in business, that all earnings, income, and properties acquired by both during their married life would be owned by them fifty-fifty, and that they would be equal partners in all respects, equally owning and enjoying their earnings and acquisitions of property. * * * In accordance with this agreement, their properties, accumulations, earnings and incomes have continuously since date of marriage been combined in a common fund, from which all expenses of both have been paid, as evidenced by joint bank accounts created immediately after marriage where all salaries, earnings and profits from whatsoever source were deposited and against which account each was authorized by written contract with the banking institution to draw." Assuming that this statement by petitioner of the scope and nature of the agreement and what was done under it is correct, we are of the opinion that the view taken by the Commissioner and the Board of Tax Appeals was right. Admittedly, it is quite unimportant that the understanding originated before marriage, for, under the settled rule in California, a post-nuptial agreement of like character would be of equal efficacy. In every material respect, therefore, the case is like *Blair* v. *Roth* (C.C.A.) 22 F. (2d) 932, and it is ruled by our decision therein. See, also, *Lucas, Com'r* v. *Earl,* 50 S. Ct. 241, 74 L. Ed. — (United States Supreme Court Decision, March 17, 1930).

Thus the principles announced by this Court in the *Roth* case were in no way impaired by anything this Court had said in the *Earl* case, and we know of no decision of either this Court or of a California appellate court rendered since which has done so. It is furthermore to be noted in this connection that, while in its decision in *Lucas* v. *Earl, supra,* the Supreme Court did not specifically answer the taxpayer's contrary contention, because it decided that case on a construction of the federal statute, nevertheless, it went out of its way emphatically to suggest that, at least for federal tax purposes, the earnings would be regarded as vesting in him who had earned them for a sufficient length of time to impress them with the status of his earnings.

And this brings us to a consideration of the question whether, even assuming that the taxpayer's future earnings were actually converted into the separate property of himself and his wife by the agreement, that fact was effective to prevent the application of Section 1000(d) to the actual division which occurred in each of the taxable years.

B. *Assuming that the agreement was effective to convert the taxpayer's future earnings into the separate property of the taxpayer and his wife, this was nevertheless ineffective to prevent the application of Section 1000(d)*

Assuming, then, that the agreement is to be given the same effect as was given by this Court to the agreement in the *Earl* case, it still does not follow that the conversion will escape the impact of Section 1000(d), provided, of course, that such conversion resulted in a gift which, as has already been stated, we shall undertake to demonstrate under the second point of our argument. In other words, the assumption here is that the taxpayer's earnings were not intended to be community property because of the agreement, and our argument under this point proceeds on that assumption.

At the outset, we submit that, if the *income* tax statute must be construed so as to avoid the technical results of such an agreement, as the Supreme Court said it must be in *Lucas* v. *Earl, supra,* then obviously the *gift* tax statute here in question must likewise be so construed; for the indubitable purpose of Section 1000(d) is to attribute a gift of property to the husband unless the property is economically attributable to the wife, regardless of the fact that under community property law one-half thereof is regarded as being owned by and vested in each of the spouses. *A fortiori, Lucas* v. *Earl* is applicable, for therein the Supreme Court said (pp. 114-115):

> There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.

Indeed, the reason for so holding here is even more obvious than it was in respect of the income tax provision. For here Section 1000(d) expressly, instead of only implicitly as in the case of the income tax section, provides that the gift tax is to be imposed upon the husband unless the property is economically attributable to the wife.

Moreover, even though it is assumed that the agreement of January 1, 1939, was intended to convert future earnings of the taxpayer, which would be community property, into separate property of the two spouses, it is not until the right to the earnings accrues that a gift thereof can become effective. It was not until the taxpayer became entitled to and received the earnings in the taxable years that an actual conversion could occur. Thus, only when the earnings came into existence, could there be a completed transfer of them by gift through the medium of dividing them. Assuredly, the agreement would not have prevented the imposition of the tax if the gift of the taxpayer's earnings had been made to a third person. It follows that it could not defeat the tax if the gift was made to the taxpayer's wife.

Obviously a contention that Congress intended to require that the property retain its technical status of community property as an indispensable condition to the imposition of the tax under Section 1000(d) would be feckless in the light of the obvious Congressional purpose to capture the tax on transfers made by him to whom the subject of the gift was economically attributable, despite the fact that it was community property. The emphasis in Section 1000(d) is not on the fact that the property is community property. Its purpose is not to levy the tax on gifts of community property because the gift is of such property. Its purpose is rather to place the burden of this tax upon the spouse to whom community property is economically attributable, so that by necessary implication Section 1000(d) strikes at anticipatory arrangements which, by depriving the property of its community property status, would serve only to emasculate the statute and to defeat its manifest purpose. This is particularly true when, as here, as a result of such an arrangement, both the title and the ownership of the property is left in substantially the same situation as it was as community property, but out of the reach of the statute unless the arrangement is disregarded.

Subsequent decisions of the Supreme Court in which the doctrine of *Lucas* v. *Earl, supra,* has been applied make it clear that the Court regarded the assignment of the income in that case as complete before the taxable year.

Thus in *Burnet* v. *Leininger,* 285 U. S. 136, 142, the Court expressly assumed that Mrs. Leininger, the assignee of one-half of the income received by her husband from a partnership, had become the beneficial owner of such half, saying that it was still true that he, and not she, was the member of the firm, and that she had only a derivative interest. So in *Burnet* v. *Wells,* 289 U. S. 670, 677, the Court said, citing both the *Earl* and *Leininger* cases in support thereof, as well as other decisions following them, that at times escape from the tax had been blocked by the resources of the judicial processes without the aid of legislation, and that in these and other cases, there had been a progressive endeavor by the Congress and the courts to bring about a correspondence between the legal concept of ownership and the economic reality of enjoyment or fruition, and that, "Of a piece with that endeavor is the statute now assailed." Could it possibly be denied that of a piece with that endeavor is the statute here assailed?

Again, in *United States* v. *Joliet & Chicago R. Co.,* 315 U. S. 44, 46, the Court said *Lucas* v. *Earl, supra,* had held that a husband's salary was taxable to him though by contract with his wife half of it vested in her when paid. In *Helvering* v. *Horst,* 311 U. S. 112, 114-115, the Court pointed out that in both the *Earl* and *Leininger* cases the assignment of compensation for services had preceded the rendition of the services, and in *Commissioner* v. *Harmon,* 323 U. S. 44, 46, the Court said:

> Under *Lucas* v. *Earl* an assignment of income to be earned or to accrue in the future, even though authorized by state law and irrevocable in character, is ineffective to render the income immune from taxation as that of the assignor.

Finally, in *Poe* v. *Seaborn,* 282 U. S. 101, 117, the Court said:

> In the *Earl* case a husband and wife contracted that any property they had or might thereafter acquire in any way, either by earnings (including

> salaries, fees, etc.), or any rights by contract or otherwise, "shall be treated and considered and hereby is declared to be received held taken and owned by us as joint tenants . . ." We held that, assuming the validity of the contract under local law, it still remained true that the husband's professional fees, earned in years subsequent to the date of the contract, were his individual income, "derived from salaries, wages, or compensation for personal services" under §§ 210, 211, 212 (a) and 213 of the Revenue Act of 1918. The very assignment in that case was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate.

To be sure, the Court concluded that, in view of the fact that the case involved the income tax on community property, a different question was presented, because, under community property law, "the earnings are never the property of the husband, but that of the community." But it was precisely that situation which Congress intended to overcome in enacting Section 1000(d) so far as concerns the taxation of gifts of community property, including the earnings of either spouse. And it did so by providing, in effect, that the ownership of community property was for gift tax purposes attributable to the spouse to whom it was economically attributable.[2] If Congress had similarly attributed the ownership of such property for income tax purposes to the spouse to whom it was economically attributable, there could, of course, be no question that the principle of *Lucas* v. *Earl, supra,* would be applicable. No reason is perceived, therefore, why it should not apply to Section 1000(d).

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[2] See H. Rep. No. 2333, 77th Cong., 2d Sess., p. 169 (1942-2 Cum. Bull. 372, 415), as also S. Rep. No. 1631, same Cong. and Sess., pp. 231-233, 243 (1942-2 Cum. Bull. 504).

It should in passing be noted that nothing said by this Court in either *Johnson* v. *United States,* 135 F. 2d 125, or in *Rogan* v. *Kammerdiner,* 140 F. 2d 569, detracts from these considerations. In the *Johnson* case, the assignment was of income which had already been earned; and in the *Kammerdiner* case the question was whether property jointly held at the wife's death was economically attributable to the surviving husband. Similarly, in *Commissioner* v. *Giannini,* 129 F. 2d 638 (C.A. 9th), the sole question was whether the income which had been attributed to the taxpayer had in fact been beneficially received by him.

Moreover, neither the case of *Helvering* v. *Hickman,* 70 F. 2d 985 (C.A. 9th), upon which the taxpayer heavily relied below, nor the case of *Van Every* v. *Commissioner,* 108 F. 2d 650 (C.A. 9th), which the Court regarded as being on all-fours with the *Hickman* case, in any way affects the validity of the conclusion that the division of the taxpayer's earnings attracts the tax here in question even if they were converted into separate property by the agreement. Both of these cases involved a relinquishment by one spouse of the earnings of the other; and, as this Court pointed out in the *Hickman* case, p. 987, the result which the agreements achieved in them is precisely the result which the statute involved in *Lucas* v. *Earl* intended to achieve, namely, to attribute the income for income tax purposes to the spouse who had earned it. It was for this reason that the Court thought the principles of that case did not serve to deprive the agreements of their normal effect for federal income tax purposes. There was, therefore, no reason for not recognizing the effectiveness of the agreement for federal tax purposes in either the *Hickman* or the *Van Every* case, and there is no necessity for inquiring whether, in some other situation, such an agreement should not be given effect to defeat the tax. As indicated, that question was not before this Court in either case and was, therefore, not answered by it in either of them. But the statute here also intended to achieve the same result for gift tax purposes, i.e., to attribute the gift of income to the spouse to whom it was economically attributable.

We, therefore, respectfully submit that the finding of the Tax Court that the agreement did not convert the property from community to separate property is supported by the evidence and should not be reversed; but that, if on the other hand it is thought that the agreement effected such conversion, then that it was nevertheless ineffective to prevent the application of Section 1000(d).

II

The Division of the Taxpayer's Earnings Between Himself and His Wife in the Taxable Years in Question Into the Separate Property of Each Constitutes a Gift by Him to Her of a Moiety Thereof in Each of Those Years Within the Meaning of Section 1000(d) of the Code

In addition to the primary question involving the construction of Section 1000(d) of the Code, the taxpayer argued in the Tax Court that, if the division of the community property of himself and his wife between them constituted a transfer within the meaning of Section 1000(a) it was for an adequate and full consideration in money or money's worth, within the meaning of Section 1002. We assume that the taxpayer will renew that contention here. Consequently, we shall also divide this part of our argument into two parts. Thus, under subpoint A, we shall undertake to show that Section 1000(d) comprehends a division of community property into the separate property of each spouse, and under subpoint B shall undertake to demonstrate that the taxpayer did not receive such consideration within the meaning of Section 1002.

A. *Section 1000(d) applies to divisions of community property into the separate property of the spouses*

The Tax Court's rejection of the Commissioner's contention that Section 1000(d) embraces a division of community property between the spouses, as the applicable Treasury Regulations, namely, Section 86.2(c) (Appendix, *infra*), provide, involves a tissue of errors, the most egregious, and indeed all comprehending of which is the fact that it struck down these Regulations.

We assume, however, that the taxpayer will argue that this Court has already, in effect, itself struck down these Regulations in the case of *Rickenberg* v. *Commissioner,* 177 F. 2d 114, because therein the Court not only struck down the cognate estate tax Regulations, but particularly because, in its opinion (p. 117, fn. 3) it referred to the fact that, in the case at bar, the Tax Court had struck down the gift tax Regulations here involved. The contention assumes, of course, that the Court referred to this fact in support of its action in striking down, in its turn, the estate tax Regulations. However, even if we regard such a conclusion to be justified, we do not understand that the Court intended by its decision in the *Rickenberg* case to foreclose the Government in fully and adequately presenting its contentions in the case at bar that the provision of Section 86.2(c) of Treasury Regulations 108 is valid in providing that a division of community property between the spouses into the separate property of each is within Section 1000 (d). In any case, we cannot accept as correct the action of this Court in striking down Section 81.15 of Treasury Regulations 105, promulgated to carry Section 811(d)(5) of the estate tax statute into effect, or its implicit approval of the Tax Court's action in striking down the cognate gift tax Regulations here in question.

While we do not intend to reargue the *Rickenberg* case here, nevertheless, what we have to say here in support of these Regulations will, we think, so conclusively demonstrate error in the Court's striking down the estate tax Regulations that the Court may feel itself constrained to overrule its decision in that case, as we think it should. In the meantime, the Solicitor General has authorized the filing of a petition for certiorari in the *Rickenberg* case, and the petition will no doubt be filed before this brief is filed. Thus, in any event, the decision in the *Rickenberg* case should be put aside, long enough, at least, to permit the Government fully to marshal the facts here which support its contention that the Tax Court committed grievous error in striking down the gift tax Regulations.

At the very outset, therefore, we wish to call the Court's attention to the fact that, even before the Tax Court's decision in this case was promulgated, Congress had itself accepted the construction placed by Section 86.2(c) of Treasury Regulations 108 upon Section 1000(d) as being the correct one. This is so because, by Section 361(a) of the Revenue Act of 1948, c. 168, 62 Stat. 110 (Appendix, *infra*), Congress amended Section 812 of the Internal Revenue Code so as by Subsection (e)(2)(C)(i) thereof to provide, on the one hand, for the *exclusion* from the estate tax base, for the purpose of computing the marital deduction, of conversions of community property into the separate property of the spouses effected both *prior* and *subsequent* to the period during which Section 1000(d) was effective; the corollary of this provision being the *inclusion* in the estate tax base of such conversions as were effected during the period that Section 1000(d) was effective. Similarly, by Section 372 of the 1948 Act (Appendix, *infra*), Congress amended Section 1004 of the Code so as by Subsection (a)(3)(F) (iii) of that section to provide for the *exclusion* from the gift tax base, for the purpose of computing the marital deduction, only of conversions of community property *between the donor and the donee spouse*—mark these words—which occurred both prior to and after the period during which Section 1000(d) was effective.

The obvious reason for not excluding from such bases in both cases conversions which were effected during the period that Section 1000(d) was in effect was that, during such period such conversions were regarded by Congress as constituting taxable transfers to the spouses to whom the property was not economically attributable under Section 1000(d). Thus the striking down of the Regulations upsets the calculation of the marital deduction expressly provided by Congress, in Section 812(e)(2) in computing the estate tax and in Section 1004(a)(3) in computing the gift tax. In this connection, of course, sight should never be lost of the fact that the purpose of such marital deductions was to place citizens of common law states in a position of equality for both estate and gift tax purposes with residents of community property states. See H. Rep. No. 1274, 80th Cong., 2d Sess., pp. 24-26 (1948-1 Cum. Bull. 241, 260-261); S. Rep. No. 1013, same Cong. and Sess., pp. 26-29 (1948-1 Cum. Bull. 285, 303-306). That full equality was achieved by the 1948 amendments may well be questioned, but at least Congress thought that such amendments would serve better to equalize these taxes than the 1942 amendments had done, for both reports above referred to specifically so state, pp. 26 and 27, respectively (1948-1 Cum. Bull., pp. 261, 305, respectively).[3]

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[3] For an instructive discussion of the background of the 1948 Act, see Sugarman, Estate and Gift Tax Equalization, 36 Cal. L. Rev., 223-226 (1948).

Thus, while, as stated, under Section 812(e)(2)(C)(i) and Section 1004(a)(3)(F)(iii), community property, which is excluded from the estate and gift tax bases, includes the separate property acquired as a result of a division of community property between the spouses, when such division takes place both *before* and *after* the period during which Section 1000(d) was in effect, separate property resulting from such division occurring *during* the effective period of that Section is not treated as community property and is *included* in the bases under Sections 812(e)(2)(C)(i) and 1004(a)(3)(F)(iii) for determining the marital deduction.

We think it brooks no denial that Congress included in the estate and gift tax bases, for purposes of computing the marital deduction, conversions of community property occurring during the period in which the 1942 Amendments were in effect, because it regarded them as having constituted taxable transfers under Section 1000(d). Indeed, there is no other conceivable reason why Congress should so painstakingly have differentiated between conversions occurring during that period and those occurring both before and thereafter. See Surrey,[4] Federal Taxation of the Family—The Revenue Act of 1948, 61 Harv. L. Rev. (1948) 1097, where the author explains the exception in respect of the estate tax and the reason therefor which we have given, as follows (pp. 1124-1125):

> Some separately held property is treated as community property. In the case of community property which was converted in [the] calendar [year] 1942, or is converted after April 2, 1948, into separately held property of the spouses (including joint tenancy or any other form of joint owner-

[4] The author, Stanley S. Surrey, now at the School of Jurisprudence of the University of California, was Tax Legislative Counsel of the Treasury Department in the years 1942 to 1947, inclusive.

> ship), the separate parts are considered community property for the purpose of the 50% limitation and hence must be subtracted to find the adjusted gross estate. Since no gift tax was or is payable on such conversion, failure to require subtraction of such property for purposes of the limitation would make avoidance of the entire special community property rule relatively simple. But the safeguard adopted involves tracing problems, especially since its effectiveness demands that the artificial community property designation still apply to any separate property received in subsequent exchanges. Conversions in the period between 1942 and April 2, 1948, are not within this artificial treatment, since a gift tax was payable then.

A similar explanation is made by him ~~at~~ (pp. 1141-1142), of the exception in respect of the gift tax.[5]

The basis of both Sections 811(d)(5) and 1000(d), of course, is that, for estate and gift tax purposes, Congress treated the one to whom the property was economically attributable as the owner of the property, in studied disregard of the rules of state law which give to each spouse a so-called vested interest in one-half of the property. *Poe* v. *Seaborn,* 282 U. S. 101, whose doctrine was, in *United States* v. *Malcolm,* 282 U. S. 792,

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[5] Sugarman does not specifically explain, in his article referred to in fn. 3, *supra,* why under Section 812(e)(2)(C)(i) and Section 1004(a)(F)(iii) transfers of community property between husband and wife, made during the effective period of the 1942 estate and gift tax amendments, were includible in the estate and gift tax base for purposes of the marital deduction, though he does explain (pp. 269 and 273) that only such divisions as were made in 1942 and after April 2, 1947, are includible therein. However, in this connection, he points out (p. 769, fn. 168) that transfers of pre-1927 community property of the spouses, i.e., those made before and after the effective period of the 1942 amendments referred to in the text which the footnote supports, are includible, because the gift tax was paid thereon; and, as we have said, this is precisely the reason why such division under Section 1000(d) was made includible under the 1948 Act in both the estate and gift tax bases.

regarded by the Supreme Court as applicable to California post-1927 community property. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 160, 169 (1942-2 Cum. Bull. 372, 489, 496), as well as S. Rep. No. 1631, same Cong. and Sess., pp. 231-232, 243 (1942-2 Cum. Bull. 504, 673-674, 682), already referred to in fn. 2, *supra*. Both reports expressly state that Section 811(d)(5) attributes the transfer to the spouse to whom the property is economically attributable and thus establishes a uniform federal rule for apportioning the respective contributions of the spouses regardless of varying local rules of apportionment, and that, accordingly, state presumptions are not operative against the Commissioner. Certainly, nothing could be plainer.

However, if more is required, we respectfully refer the Court to the discussion of both Sections 811(d)(5) and 1000(d) by Paul [6] in his 1946 Supplement to Federal Estate and Gift Taxation, where he says (pp. 210-211), first with regard to Section 811(d)(5):

> Although the statute [Section 811(d)(5)] does not expressly mention interspousal transfers, there is certainly no implication that it was intended to embrace only transfers to third persons. As a matter of fact, the very absence of any language of limitation is cogent evidence that none was intended. Moreover, a contrary conclusion would require one to assume that while Congress took pains to establish a special rule for community property owned by the decedent and spouse at the former's death, regardless of whether the property passes to the spouse or another, for some reason it has applied the same rule to taxable *inter vivos* transfers only if the property is bestowed upon a third

[6] Aside from being the outstanding authority on federal gift and estate taxation, Randolph E. Paul was Tax Adviser of the Treasury Department in 1942 and represented the Treasury before the Congressional Committees in connection with the 1942 Revenue Bill, which became the Revenue Act of 1942, c. 619, 56 Stat. 798. Later, of course, he served as Chief Counsel of the Treasury.

> person. The anomaly becomes all the more striking when it is recalled that the provisions reaching transfers prior to death are intended to prevent avoidance of the tax which would apply if the property had been retained until death.

Following this up, Paul explains Section 1000(d) in relation to Section 811(d)(5), as follows (pp. 719-721):

> Section 1000(d) of the Code conforms closely to the basic estate tax amendments. The property is taxed to one spouse or the other on the basis of economic source. There is, however, a difference in the play of presumptions. Under the estate tax provision, which is somewhat analogous to the statute governing joint tenancies and tenancies by the entirety, there is an initial presumption that the community property is attributable to the decedent, whether husband or wife. The gift tax amendment, on the other hand, attributes community property to the husband in all cases unless the contrary is shown. Each amendment is conveniently fashioned to suit the needs of the occasion.
>
> The change in gift tax incidence is not confined to transfers of community property to third persons. According to the regulations, the amendment applies as well "to a division of such community property between husband and wife into the separate property of each, and to a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of the wife, or into a joint estate or tenancy by the entirety of both spouses. In all of such cases the value of the property so transferred or so divided, as the case may be, is a gift by the husband to the extent that it exceeds the aggregate amount of the value of that portion which is shown to be economically attributable to the wife . . . and of the value of the husband's interest in such property after such transfer or division. The value of the property so transferred or so divided, as the case may be, is a gift by the wife to the extent that the portion of such value which is shown to be economically at-

tributable to her . . . exceeds the value of her interest in such property after such transfer or division."

The regulations solve, at least temporarily until the courts have spoken, the question whether Section 1000(d) extends to a division of community property between the spouses or the transformation of such property into the separate property of one of the spouses or property owned by the spouses jointly, by the entirety or in common. Few, if any, will quarrel with the amendment's effect upon transfers of community property to third persons, once strongly entrenched assumptions about the Constitution are overcome. There is a tendency, however, to place interspousal transfers within an insulated compartment, wherein community property concepts may continue an undisturbed and hence happy existence. This attitude seems to be premised upon two factors, namely, the absence from the amendment of an express reference to interspousal transfers and the wife's position as co-owner in community property theory. Before examining these factors as they affect the merits of the regulation, the effect of limiting the amendment to transfers outside the community should be noted. Under the estate tax the transfer to the wife of community property attributable to the decedent-husband is taxable to the latter's estate. It makes no difference whether the wife or a stranger succeeds to the ownership. But if the complementary gift tax provision did not include interspousal transfers, the husband would be free to effect the same result during life without payment of a commensurate tax. Moreover, even avoidance of gift tax upon transfers to third persons would be encouraged. A husband wishing to make a gift of community property to others would first divide the property into equal portions, the husband owning one and the wife the other, and at a later date each could transfer his share to the desired beneficiary. The amendment would simply be turned into a fairly useless gesture, effective only as to those who failed to do the necessary maneuvering. It seems more reasonable to assume, however, that in enacting legislation to deal with *inter vivos* transfers of community property, Congress intended the legislation to be effective, especially since it is intended to "protect" the estate tax.

While Section 1000(d) does not expressly mention the reshuffling of ownership as between the spouses, it does not follow that the regulations have gone too far afield. The purpose of the section, reflected as well by the estate tax amendment, is to pierce the property categories of local law and to attribute ownership of the community property to one spouse or the other in the light of stated economic criteria. If—to take the simplest and most common case—the community property is completely attributable to the husband, it is treated as if it belongs solely to him. Hence it makes no difference whether the property is given to the wife or to a third person, unless the difference derives from the wife's co-ownership under local law. However, a distinction established on this basis would simply read back into the statute the very concept of ownership which engendered the discriminations calling for legislation. And it would require one to assume that the gift tax treatment of interspousal transfers was intended to diverge sharply from the status of such transfers under the estate tax, although the committee reports observe that the gift tax amendment "is similar to the estate tax amendment."[7]

Although Sections 811(d)(5) and 1000(d) do not expressly refer to interspousal transfers, the broad language used assuredly covers them, as well as transfers of community property to third persons. As stated

[7] As we have shown, the 1948 legislation completely confirms the correctness of Paul's analysis of the problem and demonstrates as baseless the criticism of it by Brown and Sherman in their article Division of Community Property as Taxable Gifts, 22 Cal. State Bar Journal 122 (1947), which the taxpayer cited and relied on below and will no doubt again cite and rely on here.

by Paul, *supra,* p. 210, "the very absence of any language of limitation is cogent evidence that none was intended," citing, fn. 34, *Commissioner* v. *Becks Estate,* 129 F. 2d 243, 244-246 (C.A. 2d). Here the avowed purpose of Congress was, as stated, so far as it was possible by the method adopted, to do away with the preferential estate and gift tax treatment of community property and to equalize these taxes as between citizens of common law and community property states. But this could fully be accomplished by such means only by regarding the spouse to whom the community property was economically attributable as its owner not only for purposes of transfer to third persons, but for purposes of interspousal transfers as well. The basic premise of both Sections 811(d)(5) and 1000(d) is that the spouse who is the economical source of community property has a sufficient property interest in the other spouse's half to justify inclusion of its value on the one hand in the decedent's gross estate and on the other in the total amount of gifts when it has been conveyed *inter vivos* not only to a third person, but to the other spouse, as well, by a transfer described in Section 1000(d). The statute not only does not exempt from its terms interspousal transfers, but no rational reason has or can be suggested for assuming that Congress intended to exempt them. To the contrary, the statute focuses on the transfer by the husband of his interest in his wife's community half of the property as a taxable event, and where there has been such a transfer it obviously is irrelevant who might be the transferee. The statute would fail of its purpose wholly to equalize these taxes as between citizens of common law and community property law states within the framework of the 1942 amendments, unless Section 1000(d) encompassed interspousal transfers. Thus if, nevertheless, such an exception is made by the courts, it will be nothing short of a wholly unwarranted judicial graft upon the statute, for such an exception is in the teeth of the Congressional purpose to equalize the tax and, to the extent of the exception, thwarts such purpose.

Assuredly, there is nothing to prevent Congress from treating the husband, except to the extent the community property is economically attributable to the wife, as the owner thereof and accordingly taxing him upon its transfer to the other spouse. His exclusive management and control are sufficient for this insofar as the wife's half of the property is concerned.[8] The power of Congress to regard the shifting of the husband's control over the wife's half of the community property as a sufficient basis for both estate and gift tax purposes can, of course, no longer be questioned. *Fernandez* v. *Wiener,* 326 U. S. 340; *United States* v. *Rompel,* 326 U. S. 367. But to concede, as it must be conceded, that the husband may be treated as the owner of that property interest in respect of transfers to a third person, is likewise to concede that he may be treated as such owner in respect of an interspousal transfer. It would seem to follow that since he must be so considered in the one case, he must likewise be so considered in the other, as the Regulations, correctly, we think, provide.

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[8] Section 161(a) of Deering's Civil Code of California (1949) expressly provides that the wife's present, existing and equal interest in the community property shall be under the management and control of the husband. Under Section 172 of the Civil Code the husband has management and control of community personal property, with like absolute power of disposition, other than testamentary, as he has over his separate property, except that he can not give it away without a valuable consideration and he can not dispose of the home furnishings or the apparel of the wife or minor children without the wife's written consent. The wife also, under Section 172a, must join in executing any conveyance, or lease in excess of one year, of community real estate. Under these sections the community property, both real and personal, may be used to pay the husband's separate debt and tort liabilities. *Grolemund* v. *Cafferata,* 17 Cal. 2d 679, certiorari denied, 314 U. S. 612.

As the Supreme Court said in *Commissioner* v. *South Texas Co.,* 333 U. S. 496, 501:

> This Court has many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons.

citing *Fawcus Machine Co.* v. *United States,* 282 U.S. 375. The question is not whether the Regulations are free from doubt, but whether they are reasonable. *Brewster* v. *Gage,* 280 U. S. 327. The Regulations here not only state a conclusion in accord with, and indeed demanded by the statutory language itself, but they are reasonable; for, as we have repeatedly said, they implement the purpose of Congress to give geographic uniformity to the estate and gift tax statutes, so that transfers of the property from one spouse to the other having similar economic aspects shall be treated alike taxwise throughout the United States. Moreover, as already pointed out, Congress in connection with Sections 361 and 362 of the Revenue Act of 1948 has approved the Regulations. In this connection, it has been held that a Regulation is not unreasonable because it defines property for federal tax purposes in disregard of local law. See *United States* v. *Pelzer,* 312 U. S. 399, 402, 403, and cases there cited, and particularly the decision of this Court in *United States* v. *Lambeth,* 176 F. 2d 810. Here, of course, the statute itself disregards the wife's "ownership" of her community half under local law and the Regulations do not go beyond the statute in that respect.

Of course, what has been said disposes of the Tax Court's notion that the wife's ownership of one-half of the community property under California law is a controlling consideration, and that because of such ownership there cannot be a "gift" for federal gift tax purposes of such half from the husband to the wife, with the result that a division of the community property between them cannot be regarded as a transfer from the husband to her of such half. Also disposed of, we think, is the Tax Court's corollary notion that, because of the status of the title to community property under local law, no intention can be imputed to Congress to attribute the ownership thereof to the spouse to whom it was economically attributable, at least not for the purpose of imposing a gift tax upon its transfer to the other spouse.

Further disposed of is the Tax Court's definition of the term "gift" as used in the statute. Sections 1000(a) and (d) and 1002 must, of course, be read together. In combination, they provide for the imposition of the gift tax upon a transfer of property to the extent that the transferor has not received an adequate and full consideration in money or money's worth, including transfers of community property which are deemed to be made by the husband, except to the extent the property is economically attributable to the wife. Obviously, Congress did not use the word "gift" in Section 1000(d) in a different connotation from what it used the word "transfer" in Section 1000(a) taken in conjunction with the provisions of Section 1002 with regard to consideration; and obviously also Congress regarded the husband's interest in the wife's community half of the property as property, the transfer of which by him was to be taxed.

The Supreme Court has repeatedly said that the definition of the word "gift" as used in the statute is not, as the Tax Court supposed, the common law definition thereof, but embraces any transfer of an interest in property (other than one made in the ordinary course of business), to the extent that it was made for less than an adequate and full consideration in money or money's worth, and that no donative intent is necessary. *Commissioner* v. *Wemyss,* 324 U. S. 303. See also *Merrill* v. *Fahs,* 324 U. S. 308. Indeed, this Court has itself so held. *Commissioner* v. *Greene,* 119 F. 2d 383, 386. As the Supreme Court pointed out in the *Wemyss* case, p. 306, Congress used the word "gifts" in its broadest and most comprehensive sense, choosing not to require an ascertainment of what too often is an elusive state of mind. See also to the same effect *Smith* v. *Shaughnessy,* 318 U. S. 176, 180. Hence, for purposes of the gift tax, as the Supreme Court said in the *Wemyss* case, Congress not only dispensed with the test of "donative intent," but formulated a much more workable external test, namely, that, when "property is transferred for less than an adequate and full consideration in money or money's worth," the excess of such money value "shall for the purpose of the tax imposed by this title, be deemed a gift . . ."; and that, moreover, Treasury Regulations had emphasized that common law considerations were not embodied in the gift tax.

Moreover, the definition of the term "gift" includes the abandonment of control over the property. *Smith* v. *Shaughnessy, supra,* p. 181; *Merrill* v. *Fahs, supra*; *Commissioner* v. *Bristol,* 121 F. 2d 129 (C. A. 1st). The relinquishment of a right in property satisfies all of the requirements of the statute. *Burnet* v. *Guggenheim,* 288 U. S. 280.

Indeed, the tax is not laid on the property at all, but on the donor's disposition of his interest therein, whatever that may be. *Phipps* v. *Commissioner,* 91 F. 2d 627 (C. A. 10th).

It follows that the Tax Court's definition of the term "gift" is erroneous and does not serve to advance the taxpayer's contention.

Finally, on this phase of the case, it should be noted that the gift tax is an adjunct to the estate tax, its purpose being to prevent tax-free depletion of decedents' estates by requiring that the transferor receive not only an adequate and full consideration, but that this be in money or money's worth. *Estate of Sanford* v. *Commissioner,* 308 U. S. 39, 43; *Smith* v. *Shaughnessy, supra,* p. 180; *Merrill* v. *Fahs, supra,* p. 311; *Commissioner* v. *Bristol, supra.* Thus, contrary to the Tax Court's view, in the case at bar, the transfer amply satisfies the requirement of Section 1000(d) in that the taxpayer relinquished his control of the property, or of his wife's half.

There is another argument which the taxpayer made below and which he will no doubt renew here, and that is that there is no warrant in the statute for the further provision in Section 86.2 (c) of Treasury Regulations 108 to the effect that a transfer of separate property into community property is not subject to gift taxes under Section 1000(d) as theretofore. The rationale of that provision, however, lies in the fact that under this Section the economic right of the property determines the ownership for gift tax purposes. It follows that a transfer of separate property by the husband to the community must be regarded as a transfer by the owner to himself. Paul explains this fully in his 1946 Supplement to Federal Estate and Gift Taxation, p. 721:

> Pursuing further the basic theory of a redefined "tax ownership," the regulations add that no gift tax liability is imposed upon "a transfer on or after January 1, 1943, of separate property of either spouse into community property." Hence, if a husband transforms his separate property into community property there is no gift tax, since from the tax point of view he is still owner of the property. On the other hand, a subsequent shift of

ownership from the community to the wife would constitute a taxable transfer.

Thus, one after the other, the Tax Court's reasons for holding that the division of the community property here in question did not attract the gift tax have been shown to be invalid. To sum up, these are: (1) That the Regulations are invalid in that they provide that Section 1000(d) comprehends a division of community property between the spouses into separate property; (2) that Congress intended the state law to be still controlling; (3) that the division here in question did not satisfy the definition of the term "gift" as used in the statute, and (4) that a relinquishment of the husband's control over his wife's half of the community property did not do so.

This leaves for consideration the question whether the transfer here in question was for an adequate and full consideration in money or money's worth within the meaning of Section 1002.

B. *There was no adequate and full consideration in money or money's worth for the transfer within the meaning of Section 1002 of the Code*

The consideration which Section 1002 requires is not a common law consideration. See *Commissioner* v. *Wemyss, supra; Commissioner* v. *Greene, supra,* and *Commissioner* v. *Bristol, supra.* Nor are mutual promises sufficient to satisfy the statutory requirements. *Robinette* v. *Helvering,* 318 U. S. 184. The consideration must benefit the donor in terms of money and money's worth, and must do so adequately and fully; neither benefit nor detriment to the donee is consideration. *Commissioner* v. *Wemyss, supra.* Indeed, the purpose of the statute is to reach those gifts which are withdrawn from the donor's estate. *Commissioner* v.

Wemyss, supra. Moreover, interspousal transactions, although they conceivably may be such, ordinarily are not business transactions and, unless they are, they do not fall within the ambit of Section 1002. See *Taft* v. *Bowers,* 304 U. S. 351; *Commissioner* v. *Wemyss, supra; Merrill* v. *Fahs, supra; Giannini* v. *Commissioner,* 148 F. 2d 285 (C.A. 9th). And, in any case, Congress would have done a futile act in imposing a tax on the division of community property, in order to equalize the tax throughout the United States, if it were to be defeated by the very fact that, as a result, each spouse received a moiety of the property of equal value, which, indeed, each already "owned."

But, regardless of all that, neither the benefits accruing to the taxpayer from the severance here nor, for that matter, the detriments are calculable in terms of money or money's worth. They cannot, therefore, be taken into account. *Robinette* v. *Helvering, supra.* The taxpayer benefited only to the extent that, after the transfer and as a result thereof, he could make a voluntary gift of his half of the property without his wife's consent.

On the other hand, the taxpayer suffered material detriments as a result of the division, also not calculable in terms of money or money's worth, in that he was required to pay not only all his own debts out of the half interest in the property he had received, but all community debts, as well.

Moreover, specifically in the case of the estate tax, and certainly impliedly in the case of the gift tax, such division is neither to be regarded as being for an adequate and full consideration in money or money's worth, nor as implying such consideration. Certainly Congress would have done a futile act in imposing a tax upon the division of community property, if the tax were defeated by the very fact that there was a division whereby each spouse received a moiety of the property of equal value.

We submit that the transfer does not fall within Section 1002.

CONCLUSION

For the reasons stated the decisions of the Tax Court should be reversed.

Respectfully submitted,

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or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * * * *

"(2) *Computation of Adjusted Gross Estate.*—

* * * * *

"(C) *Same—Conversion Into Separate Property.*—

"(i) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of subparagraph (B) of this paragraph as not so held) was by the decedent and the surviving spouse converted, by one transaction or a series of transactions, into separate property of the decedent and his spouse (including any form or co-ownership by them), the separate property so acquired by the decedent and any property acquired at any time by the decedent in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clauses (i), (ii), and (iii) of subparagraph (B), be considered as 'held as such community property'.

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 812.)

SEC. 371. GIFTS OF COMMUNITY PROPERTY.

Section 1000 (d) of the Internal Revenue Code (relating to gifts of property held as community property) is amended by adding at the end thereof a new sentence to read as follows: "This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948."

(26 U.S.C. 1946 ed., Supp. II, Sec. 1000.)

SEC. 372. MARITAL DEDUCTION.

Section 1004 (a) of the Internal Revenue Code (relating to deductions in computing net gifts in the case of a citizen or resident of the United States) is hereby amended by adding at the end thereof a new paragraph to read as follows:

"(3) *Gift to Spouse.*—

"(A) *In General.*—Where the donor transfers during the calendar year (and after the date of the enactment of the Revenue Act of 1948) by gift an interest in property to a donee who at the time of the gift is the donor's spouse—an amount with respect to such interest equal to one-half of its value.

* * * * *

"(F) *Community Property.*—

"(i) A deduction otherwise allowable under this paragraph shall be allowed only to the extent that the transfer can be shown to represent a gift of property which is not, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country.

"(ii) For the purposes of clause (i), community property (except property which is considered as community property solely by reason of the provisions of clause (iii) shall not be considered as 'held as community property' if the entire value of such property (and not merely one-half thereof) is treated as the amount of the gift.

"(iii) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of clause (ii) as not so held) was by the donor and the donee spouse converted, by one transaction or a series of transactions, into separate property of the donor and such spouse (including any form of co-ownership by them), the separate property so acquired by the donor and any property acquired at any time by the donor in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clause (i), be considered as 'held as community property'.

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 1004.)

Treasury Regulations 105, promulgated under the Internal Revenue Code:

Sec. 81.15 [as amended by T. D. 5239, 1943 Cum. Bull. 1081, 1084] *Transfers during life.*—* * *

In the case of estates of decedents dying after October 21, 1942, a transfer to a third party or third parties of property held as community property by the decedent and spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered, in accordance with section 811(d)(5), as added by section 402(a) of the Revenue Act of 1942, for the purposes of this section and sections 81.16 through 81.21, inclusive, to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the spouse or derived originally from such compensation or from separate property of the spouse. The same statutory provisions apply in the case of a division of such community property between the decedent and spouse into separate property, and in the case of a transfer of any part of the community property into separate property of such spouse; in such cases, the value of the property which becomes the separate property of such spouse, with the exception stated in the preceding sentence, shall be included in the gross estate of the decedent under section 811 (c) or section 811 (d), if the other conditions of taxability under such sections exist. If in the case of a decedent who died after October 21, 1942, property

> held as community property by such decedent and his spouse is transferred to themselves as joint tenants or as tenants by the entirety, the transfer is taxable under section 811(c), except with respect to such part of the property so transferred as is attributable to the spouse under the exception stated in the first sentence of this paragraph. With respect to the meaning of property derived originally from such compensation or from separate property of the spouse and to the identification required, see section 81.23.

Treasury Regulations 108, promulgated under the Internal Revenue Code:

> SEC. 86.2 *Transfers Reached.*—* * *
>
> * * * * *
>
> (c) *Transfers of community property after 1942.*—During the calendar year 1943 and any calendar year thereafter any gift of property held as community property under the law of any State, Territory, or possession of the United States, or any foreign country constitutes a gift of the husband for the purpose of the gift tax statute (regardless of whether under the terms of the transfer the husband alone or the wife alone is designated as the donor or whether both are so designated as donors), except to the extent that such property is shown (1) to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation, or (2) to have been derived originally from separate property of the wife. The entire property comprising the gift is prima facie a gift of the husband, but any portion thereof which is shown to be economically attributable to the wife as prescribed in the preceding sentence constitutes a gift of the wife.
>
> The rule stated in the preceding paragraph applies alike to a transfer by way of gift of community property to a third party or third parties, to a division of such community property between husband and wife into the separate property of each, and to

a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of the wife, or into a joint estate or tenancy by the entirety of both spouses. In all of such cases the value of the property so transferred or so divided, as the case may be, is a gift by the husband to the extent that it exceeds the aggregate amount of the value of that portion which is shown to be economically attributable to the wife, as prescribed in the preceding paragraph, and of the value of the husband's interest in such property after such transfer or division. The value of the property so transferred or so divided, as the case may be, is a gift by the wife to the extent that the portion of such value which is shown to be economically attributable to her, as prescribed in the preceding paragraph, exceeds the value of her interest in such property after such transfer or division. See examples (5) and (6) of subsection (a) of this section. No gift tax results from a transfer on or after January 1, 1943, of separate property of either spouse into community property.

Property derived originally from compensation for personal services actually rendered by the wife or from separate property of the wife includes property that may be identified as (1) income yielded by property received as such compensation or by such separate property, and (2) property clearly traceable (by reason of acquisition in exchange, or other derivation) to property received as such compensation, to such separate property, or to such income. The rule established by this statute for apportioning the respective contributions of the spouses is applicable regardless of varying local rules of apportionment, and State presumptions are not operative against the Commissioner.

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